MULTIMEDIA UNIVERSITY

STUDENT IDENTIFICATION NO

MULTIMEDIA UNIVERSITY

FINAL EXAMINATION

TRIMESTER 2, 2016/2017

BBF3084 – GLOBAL FINANCE

(All sections/Groups)

8 MARCH 2017
2.30 p.m. – 4.30 p.m.
(2 Hours)

INSTRUCTIONS TO STUDENT

1. This Question paper consists of 4 pages with 2 Sections only.

2. Section A: Answer **ALL** case questions.
   Section B: Answer any **THREE (3)** out of the FOUR (4) essay and calculation questions.

3. The distribution of the marks for each question is given at the end of each question.

4. Please write your answers in the Answer Booklet provided.

SECTION A: CASE QUESTIONS (40 MARKS)
INSTRUCTION: ANSWER ALL QUESTIONS

What Not to Do When Floating a Currency: Lessons for Egypt

Natasha Doff
November 4, 2016 — 1:00 PM HKT Updated on November 4, 2016 — 8:18 PM HKT

If Egypt can learn anything from emerging markets that have abandoned control of their currencies, it's that a half-hearted approach is bound to fail.

The North African country on Thursday became the latest developing nation to announce a **free float** in the past two years, unleashing a 45 percent slide in the pound to 16 per dollar, according to quotes from six banks including Commercial International Bank Egypt SAE. But the central bank's dramatic decision to allow the pound to float freely surprised some observers. "Analysts had expected the central bank would move to a **managed float of the currency**, or would announce a sharp devaluation to prop up the beleaguered pound," The Wall Street Journal reports. Whether the move eases the dollar crunch and quashes the black market will depend on how committed the central bank is to staying hands-off when currency swings ensue.

If the experience of countries like Russia, Kazakhstan and Argentina is anything to go by, the initial pain will be worth it in about a year's time, according to David Hauner, a strategist at Bank of America Corp. "Anything that is in-between, in particular any pegs that lack credibility due to a lack of reserves and are far removed from fair value, are a bad option," Hauner said from London. "This adjustment is never easy. There is clearly a period where things get worse, but when you look at the experience of countries that have moved to a free-float, it has proven to be beneficial."

For a country like Egypt that's always managed its exchange rate, the transition will be tough. There are 92 million citizens whose per-capita income is among the lowest in the Middle East and North Africa. But it is possible that these difficult measures will move the country to a more sound fiscal position.

Yet anything other than a complete break is destined to fail. When policy makers fiddle with the exchange rate, black-market activity inevitably surges, as Nigeria's experiment with a free-float attests. It can also be costly. Russia spent about $90 billion defending the ruble against short-sellers in 2014 before ultimately giving up in November that year.

Even in Egypt, attempts to manage the pound rather than unshackle it completely in 2003 and earlier this year led to soaring unofficial trading and prompted individuals and companies to hoard dollars because they lacked confidence in the currency's stability.

Source:
http://www.bloomberg.com/news/articles/2016-11-04/what-not-to-do-when-floating-a-currency-lessons-egypt-can-learn

QUESTION 1

In your opinion, what is the main cause for Egypt to manage its currency for decades? (5 marks)

QUESTION 2

Explain two (2) possible reasons as to why Egypt has abandoned its longstanding struggle to hold the value of its currency against the dollar in favour of a flexible exchange rate. (10 marks)

QUESTION 3

What is a free float? In a freely floating exchange rate system, if the current account is running a deficit, what are the consequences for the nation's balance on capital account and its overall balance of payments? Discuss with an example. (10 marks)

QUESTION 4

Do you think the depreciation of pound is an opportunity to foreigners? Discuss from the following perspectives.

i. Investment
ii. Financing
iii. Consumer

(15 marks)

(Total: 40 marks)

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SECTION B: ESSAY AND CALCULATION QUESTIONS (60 MARKS)
INSTRUCTION: ANSWER ANY THREE (3) QUESTIONS

QUESTION 1

As an employee of the foreign exchange department for a large company, you have been given the following information:

Spot rate of £	$1.5960
Spot rate of Australian dollar (A$)	$0.7000
Spot rate of £	A$3.0000
One-year forward rate of A$	$0.7100
One-year forward rate of £	$1.5800
One-year U.S. interest rate	8.00%
One-year British interest rate	9.09%
One-year Australian interest rate	7.00%

a. Determine whether triangular arbitrage is feasible and, if so, how it should be conducted to make a profit. Assume that you have $1 million or equivalent for this purpose. Calculate the profit. (12 marks)

b. Explain the international Fisher effect (IFE). What are the implications of the IFE for firms with excess cash that consistently invest in foreign Treasury bills? (8 marks)

(Total: 20 marks)

QUESTION 2

Assume the following information:

Spot rate of £	$1.4800
One-year forward rate of £	$1.5000
One-year U.S. interest rate	8.00%
One-year British interest rate	9.00%

Assume that ABC Corp. from the United States (U.S.) will receive 400,000 pounds in 1 year.

a. Describe the nature and extent of your transaction foreign exchange risk. (5 marks)

b. Would it be better off using a forward hedge or a money market hedge? Substantiate your answer with estimated revenue for each type of hedge. (10 marks)

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c. Estimate the 1-year forward rate that makes no difference to both methods. (5 marks)

(Total: 20 marks)

QUESTION 3

a. In December, 1994, ABC, a Mexican company, had debt of US$264 million. At that time, Mexico's new peso was traded at Ps3.45/US$. In December, 1995, Mexico's inflation rate surged to 12% from 7% while it was only 3% in the United States (U.S.). Calculate the number of pesos needed to repay the dollar debt. By what percent will the peso cost have gone up (down)? (10 marks)

b. For a fixed exchange rate system to work successfully, the government that oversees its operations must be able to make tight budget and monetary policies prevail from the beginning. Agree or disagree and explain why. (10 marks)

(Total: 20 marks)

QUESTION 4

a. ABC produces LED monitors and exports them to the United States. Last year the exchange rate was $1.00/euro and ABC charged 120 euro per player in Euroland and $150 per LED monitor in the United States. Currently the spot exchange rate is $1.75/euro and ABC is charging $160 per LED monitor. What is the degree of pass through by ABC on their LED monitor? Give one (1) reason why the degree of pass through not at 100 percent. (10 marks)

b. Discuss two (2) disadvantages of having highly leveraged foreign subsidiaries? (10 marks)

(Total: 20 marks)

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